UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

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OFFICE OF WATER

MEMORANDUM

SUBJECT: Costs Incurred After Contract Completion Date

FROM: James A. Hanlon, Director
Municipal Construction Division (WH-547)

Kenneth A. Konz, Assistant Inspector General for
Audit, Office of Inspector General (A-109)

TO: Municipal Construction Program Managers, Regions I-X

Divisional Inspector Generals

In an April 18, 1983 memorandum, from then Associate General Counsel Lee A. DeHihns (the DeHihns memo, Attachment 1), the Office of General Counsel addressed the allowability of the costs of resident engineer inspection and related services incurred after the scheduled contract completion date on two construction grants. Based on the facts presented and fundamental principles of grant law, the memo concluded that the costs were unallowable and that the grantees' proper remedy would be to seek liquidated damages from their contractors. While the general principles articulated in the DeHihns memo remain valid, questions have been raised by decisionmakers in both the audit and disputes resolution process about how they should be applied to a variety of situations. To address these questions, the Municipal Construction Division and the Office of Inspector General, in consultation with the Office of General Counsel, are issuing this guidance.

Background

It is fundamental EPA policy that a grantee is responsible for the successful completion of the scope of work outlined in the grant agreement. The grantee manages the completion of the project through the terms and conditions of its construction contract. EPA, as the grantor agency, is not a party to any construction contract.

The time of performance in any contract and, in particular in construction contracts, is a key provision. The grantee must develop a reasonable time of performance that is included in the contract documents when the project is bid. This is usually based on the experience of the grantee and its design engineer with other projects of comparable size and complexity, and other factors such as average weather patterns and normal equipment and materials delivery schedules. During the bidding process contractors take into consideration their experience, the information they receive from prospective equipment and materials suppliers and the required time of performance. The successful bidder ultimately agrees to the completion time in signing the contract.

The management of the average construction contract requires the coordination of dozens of individuals or firms and of decisions that direct the work and interpret the contract documents based on field conditions. Any of these factors has the potential of affecting the scope of work and possibly require a change order, including changes affecting the time of performance.

Applicable EPA regulations provide that appropriate changes to the construction contract, including changes in the time of performance, may be made. If the grantee chooses to allow the modification, it must be made through a change order. The grantee is responsible for negotiating these changes with the contractor. Relevant EPA guidance on the management of change orders on construction grant projects is contained in "Management of Construction Change Orders; A Guide for Grantees" (Change Order Guide) issued by the Office of Municipal Pollution Control in March 1983. It provides guidance to grantees, delegated State water pollution control agencies, U.S. Army Corps of Engineers (CoE) and Regional project officers regarding recommended procedures to be used in the management of project change orders including change orders with changes in the time of performance.

The level of documentation provided to support a contract change generally should be commensurate with the scope and complexity of the change. The need for minor time extensions may be obvious on their face based on the scope of work involved or other reasons cited. More extensive extensions may require a discussion of the basis of the estimate and appropriate discussions of the interrelationships of different portions of the project.

Based on the information provided by the grantee, the award official or his designee will approve or disapprove Federal participation in the change order. In essentially all cases

responsibility will either be that of the delegated State agency or the CoE. It is common program practice that change order reviews are documented on review forms which become part of the Federal project file.

Guidance

I. Introduction

The DeHihns memo restates EPA's longstanding policy that post-scheduled contract completion resident engineer inspection and associated architecture/engineering fees (post-scheduled contract completion A/E fees) are allowable provided two criteria are met. First, it must be shown that the costs were not incurred as a result of grantee mismanagement or contractor failure to perform, but rather were attributable to justifiable extensions to the time of performance, such as time extensions due to differing site conditions or unusually severe weather. Second, it must be shown that the costs were otherwise reasonable and necessary. For example, in an instance where a construction contractor could not complete a project by the contract completion date because of erroneous information supplied by the grantee's design engineer, the construction contractor could be given a time extension, but EPA would not participate in any increased costs because they resulted from the design engineer's failure to perform.

The Change Order Guide provides the baseline standards to be applied in the processing of all change orders. The Regions and delegated states are required, effective immediately, to abide by the Change Order Guide when processing change orders. Strict compliance with the Change Order Guide should minimize the possibility of future disputes over the allowability of post-scheduled contract completion A/E fees.

The guidance provided below is intended to address existing disputes in the Subpart L/Subpart F process involving the allowability of post-scheduled contract completion A/E fees. It also applies to disputes which may arise in the future regarding change orders executed prior to the date of this guidance. Section II explains what must be shown to justify construction contract time extensions in specific situations. Section III outlines the factors to be considered in determining whether post-scheduled contract completion A/E fees are otherwise reasonable and necessary. Section IV addresses audit resolution.

II. Showing to Justify Construction Contract Time Extensions

A. General Rule

In order to be allowable, post-scheduled contract completion A/E fees must be supported by a showing that justifiable reasons

existed for time extensions to the grantee's construction contract. This showing is a prerequisite to allowability in all cases and cannot be met by a demonstration that the amount of A/E fees claimed is within the cost ceiling of the A/E contract (such a demonstration, however, may be relevant to the reasonableness of A/E fees. See Section III.B below).

B. Contemporaneous and After-the Fact Change Order Approvals

Great weight should be assigned to contemporaneous change orders approved by a delegated state, the CoE or an EPA project officer (any of which is hereafter referred to as project officer approval), where the file reveals the project officer conceptually adhered to the Change Order Guide by taking a "hard look" at the need for a contract time extension and whether costs claimed were reasonable and necessary. For example, if there is evidence in the project file showing that the project officer carefully considered: the need for the time extension; the length of the extension and the allowability of A/E fees and other expenses associated with the extension then such contemporaneous project officer approvals should not be second guessed. Therefore, change orders with this support should be dispositive unless there is strong evidence to the contrary.

For contemporaneous change orders and for change orders approved after the fact where the file does not reveal that a project officer took a "hard look" at the contract time extension, an explanation of the justification for the length of the time extension and necessity and reasonableness of costs will be obtained. The level of detail in that explanation should be commensurate with the scope and complexity of the change order. Acceptable supporting documentation includes such records as contractor logs, resident inspectors diaries, A/E billing records, photographs and progress schedule records or other baseline documents. In the absence of this information, Regions must ask a grantee to submit a narrative statement or affidavit describing its review, including the documentation it considered, or they must ask for a short narrative statement from the project officer who approved the change order describing his review, including the documentation he considered. The information/ documentation used in the review of the change orders should be referenced in the project file and available for review. Regions will determine whether the documentation, the narrative statement or affidavit is adequate. The guide that should be used in the determination of allowability is the Change Order Guide. Also, where inconsistent information may be identified in the project

file or otherwise identified by the audit, that information must be reconciled with any change order approval action. Where such documentation, narrative statements, or affidavits cannot be obtained, the Region must make an independent determination about the necessity of the time extension and associated A/E fees. See Section II.C. below.

C. No Approved Change Orders

Where there are no approved change orders extending the contract completion date, Regions may work with grantees to determine if information or documentation is available to form a basis for the approval of a time extension. A grantee should supply baseline documentation as discussed above. Absent this information, a grantee must provide narrative statements or affidavits, including supporting documentation from its A/E or construction contractor explaining what happened. If, however, the grantee is unable to do so, Regions may make their own evaluation. This may be particularly appropriate in the case of small communities. For example, in the case of time extensions due to unusually severe weather where the grantee's records do not allow for a determination to be made for the entire length of the extension, the Region may be able to independently assess, based on program experience and existing information in the project file or other available records, such as weather reports and resident inspector logs, the appropriate number of days associated with the weather delays. See Townsend, Montana, EPA Docket No. 08-85-AD03 (August 19, 1987, Attachment 2). Again, the Change Order Guide should be used in that process. Regional decisions must be documented and retained, along with supporting documentation.

III. Necessity, Reasonableness and Allocability of the Costs

A. Necessity for the Costs

In order for costs to be allowable they must be necessary. Accordingly, where the project's scheduled contract completion date is extended for a certain period of time and resident engineer inspector fees are claimed for each day, it must be shown that the services performed were necessary to the successful completion of the project. Examples of documents which may be used to determine the necessity of the costs include resident inspectors' diaries, contractors' logs, photographs and progress schedule records. Also, A/E billings may be used if the billings identify the work performed and the associated costs in sufficient detail that permits a determination of the necessity and allowability of costs.

B. Reasonableness of the Costs

In determining the reasonableness of the post-scheduled contract completion A/E fees, the following general principles should be kept in mind:

First, the rates charged to the grantee during the contract extension period generally should not differ from what was originally agreed to by the grantee and the A/E;

Second, if there is an increase in the rates charged or the contract cost ceiling, appropriate documentation explaining the increase is necessary.

Third, some categories of costs are not related to the progress of construction (e.g., costs during the one year project performance period, preparation of O & M manuals, as-built drawings and "final totals" change orders on unit price contracts). Accordingly, where grantee records clearly differentiate work performed by task, these costs may be allowable regardless of whether they were incurred after the scheduled contract completion date.

C. Allocability of the Costs

In addition to being necessary and reasonable, post-scheduled contract completion A/E fees must be allocable to an EPA construction project. Typically, allocability problems may arise in the case of projects involving multiple construction contracts where A/E fees are not accounted for on an individual contract basis and where some but not all of the contracts qualify for a time extension. In such cases, separate A/E cost accounting may not be required. Instead, the allowable A/E fees may be determined through the use of a construction ratio so long as it is reasonable to assume that the level of services is consistent across the contracts.

D. Liquidated Damages

In accordance with established EPA policy, any additional costs (e.g., building, engineering, legal, or administration) incurred because of a contractor's lack of timely performance are assumed to be offset by the liquidated damages, and therefore are unallowable, even in the event that the grantee elects not to exercise its right to recover liquidated damages, or the liquidated damages are insufficient to cover the grantee's additional costs. Payment of liquidated damages provided for construction contracts generally has no bearing on the allowability of post-scheduled contract completion A/E fees. However, it evidences the contractor's responsibility for any

additional costs (i.e., those which would not otherwise have been incurred), including A/E support costs, which result from its untimely performance.

IV. Audit Resolution

Both EPA project officers and auditors should apply this guidance in their review of the allowability of post-scheduled contract completion A/E fees. Disagreements between auditors and EPA program officials over the allowability of such costs must be resolved in accordance with the requirements of EPA Directive 2750-Management of EPA Audit Reports and Follow-up Actions. The responsibility for issuing a final determination of allowable project costs on construction grants projects rests with the Action Official pursuant to that Order.

Questions about this guidance may be directed to Elissa R. Karpf of the Inspector General's Office (FTS 245-4175) or David Luoma of the Municipal Construction Division (FTS 382-5859).

Attachments

cc: Gerald H. Yamada
Harvey G. Pippen
Peter Nobert
Regional Assistance Law Contacts
Regional Disputes Coordinators
Regional Audit Follow up Coordinators

APR 18 1983

MEMORANDUM

SUBJECT: Costs Incurred After Contract Completion Date

FROM: Lee A. DeHihns /S/
Acting Associate General Counsel

TO: Ernest E. Bradley, III
Assistant Inspector General for Audits

This is in response to your December 23, 1981 request for a legal opinion on whether EPA should recoup amounts paid to a grantee for costs incurred after the contract completion date.

Issue

Should EPA recoup money paid to a grantee for costs incurred after the construction contract completion date when the grantee fails to show that the costs were not caused by its mismanagement or by the contractor's failure to perform?

Answer

Yes. Costs incurred beyond the contract completion date are unallowable for grant funding unless the grantee proves the costs were not caused by the contractor's failure to perform or by the grantee's mismanagement. Payment of liquidated damages by the contractor to the grantee is not relevant to the allowability of these costs except to the extent it evidences the contractor's responsibility for costs resulting from delayed contract completion and, therefore, demonstrates that the costs are not allowable.

Background

The issue was raised in two construction grant audits: City of Hillsboro, Ohio, Audit Report No. PZcW9-05-0041-90836; and Danville Sanitary District, Illinois, Audit Report No. PZcWG-05-713-80767.

Your 1979 audit of the City of Hillsboro questioned $6,101 (Federal share of $3,355) in resident inspection fees incurred between October 1972 and January 1973, after the contract completion date. The City of Hillsboro collected liquidated damages from the construction contractor for the same period.

Your 1978 audit of the Danville Sanitary District questioned $22,848 (Federal share $11,929) of consulting and resident engineering costs incurred after the contract completion date. These costs were questioned because they were included in a settlement between Danville and Boncar Construction Co. (contractor), whereby the contractor paid Danville $53,909.35 for costs incurred after the contract completion date.

Discussion

You have raised the issue in the context of liquidated damages, i.e., you state that in both cases the grantees have been reimbursed for the costs incurred after the contract completion date through liquidated damages, therefore, EPA should not duplicate these payments. However, even if the grantees had not collected liquidated damages the costs would be unallowable unless the grantees could show that the costs were not caused by their mismanagement or by their contractors failure to perform. The receipt of liquidated damages is not relevant to the allowability of these costs except to the extent it evidences the contractor's responsibility for costs resulting from delayed contract completion.

Overrun contract costs are unallowable for grant funding unless the grantee can document that the costs were necessary and reasonable and not caused by the contractor's failure to perform nor by the grantee's mismanagement. The principle that Federal grant recipients have the responsibility to manage grant projects efficiently and effectively to successful completion underlies all Federal grant programs and is implicit in every Federal grant. Office of Management and Budget (OMB) Circular A-87, Principles for Determining Costs Applicable to Grants and Contracts with State, Local, and Federally Recognized Indian Tribal Governments, Attachment A. Increased costs resulting from a grantee's breach of its project management responsibilities are not allowable for grant funding. OMB Circular A-87, Attachment A, §C.2.a, makes clear that to be allowable for grant funding costs must "[b]e necessary and reasonable for the proper and efficient administration of the grant programs. . . ."

The fundamental principle that grantees are responsible for properly managing Federal grant projects has been continuously reflected in EPA's regulations. The first general grant regulations issued by EPA incorporated OMB Circular A-87 by reference and restated and explained a grantee's project management responsibilities.

36 Fed. Reg. 2316-23 (1971), (later codified in 40 C.F.R. §§30.202, .600, .701 (1972)). Those initial regulations analogized a grantee's responsibilities to those of a trustee. Id., §30.202. They further explained that a grantee's management responsibilities could not be delegated or transferred, and that oversight or assistance from EPA did not relieve the grantee of those responsibilities. Id., §30.600. These explanations of grantee responsibilities have been carried through, expanded and recodified in EPA's current regulations. 40 C.F.R. §§30.210, 30.600, 35.936-5 (1981).

When a project is completed late, the grantee has the burden of demonstrating that the delay was not due to grantee mismanagement or the contractor's failure to perform. Grant projects should be finished according to schedule provided they are properly managed. As discussed above, grantees have the primary responsibility for project management. 40 C.F.R. §35.936-5 (1981).* Therefore, it is reasonable for EPA to conclude that, absent documentation to the contrary, delays in project completion are due to grantee mismanagement or the contractor's lack of performance.

In Spring City, Tennessee, EPA Board of Assistance Appeals, No. 79-36 (April 19, 1982), the Board reversed the Regional Administrator's determination disallowing increased costs incurred after the authorized construction completion date. The Region filed a motion for reconsideration on the grounds that the Board had ignored the grantee's burden to justify and document increased costs and misinterpreted the regulation requiring EPA approval of project changes. Although the Board declined to hear the motion, the Board stated that it "remains receptive to arguments that any previous appeal was decided incorrectly and should not be applied in a subsequent appeal." Spring City, Tennessee, EPA Board of Assistance Appeals, No. 79-36 (Decision on Region's Motion for Reconsideration) (Sept. 29, 1982).

*/ The specific language in 40 C.F.R. §35.936-5 explaining grantees' project management duties in the context of wastewater treatment works construction grants projects was not issued until after the Hillsboro and Danville grant awards. 40 Fed. Reg. 58604 (1975). However, the language is derived directly from the fundamental principle that grantees are responsible for proper project management and accurately describes the grantees' management responsibilities.

As evidenced by the motion for reconsideration in Spring City, the Agency takes the position that the Board erred in holding that costs incurred by the grantee after the authorized date of construction completion were allowable. In decisions issued since Spring City, the Board has upheld regions' disallowances of increased costs that are caused by delayed project completion and that are not properly justified and documented by the grantee. Marquette County Department of Public Works, Michigan, EPA Board of Assistance Appeals, No. 82-17 (January 31, 1983); City of Rohnert Park, California, EPA Board of Assistance Appeals, No. 81-89 (October 29, 1982); City of Montague, California, EPA Board of Assistance Appeals, No. 81-23 (June 30, 1982); Valdese, North Carolina, EPA Board of Assistance Appeals, No. 80-109 (June 30, 1982). If this issue is raised in subsequent appeals, the Agency will argue that the Spring City decision is incorrect and should not be followed.

Accordingly, where a project is completed late, the grantee has the burden to demonstrate that neither the grantee nor its contractors were responsible for the delay or the project costs incurred during the overrun period. Late completion of the Hillsboro and Danville projects placed this burden on the grantees.

The contract between the City of Hillsboro and its contractor included a liquidated damages provision. In brief, this provision provides for payment by the contractor to the City of Hillsboro of $100 per day for each day the completion date exceeds the time stipulated for completion, but not including extensions of time as provided for elsewhere in the contract. Further, the clause states that such sums paid are damages for the noncompletion of the work within the time stipulated for its completion. Thus, liquidated damages are monies paid by the contractor as damages for the contractor's failure to perform. As such, they evidence a contract overrun due to the contractor's lack of performance. Therefore, costs incurred during this overrun period are not allowable. As explained above, costs incurred when a project is completed late are allowable only when the grantees can show that neither the contractors nor the grantees were responsible for the delay. Payment of liquidated damages to Hillsboro shows that the contractor was responsible for the delay.

Region V's statement, as expressed in your request, that the $6,101 of excess resident inspection fees incurred during the overrun period should be allowable because even though liquidated damages were received there was no cost breakdown of the damages paid to show that they covered the excess costs incurred, is incorrect. Excess costs incurred during a contract overrun are unallowable unless the grantee can show the overrun was not due to grantee mismanagement or the contractor's failure to perform. Whether the contractor pays the grantee or not for the excess costs incurred is relevant only to the extent that liquidated damages

evidence the contractor's failure to perform. Had Hillsboro not received liquidated damages under the facts presented, the excess resident inspection fees incurred would still be unallowable for grant funding.

Danville Sanitary District, similarly, has the burden to demonstrate that the consulting and resident engineering fees incurred after the contract completion date were not due to Danville's mismanagement nor the contractor's lack of performance for those costs to be allowable. As is properly pointed out by your submission, the receipt of liquidated damages is disregarded in determining allowable costs. Your submission states that a change order was processed to extend the contract completion date through the period during which the questioned costs were incurred. The change order did not provide any justification for the extension. Thus, there does not appear to be any documentation from Danville showing that the costs were not incurred as a result of its mismanagement or the contractor's failure to perform.

Further, a settlement was reached between Danville and the contractor whereby the contractor paid Danville an amount to cover costs incurred after the contract completion date. Although correspondence between the Grants Management Section, Region V, and the Deputy Inspector General for the Northern Division, refer to the contractor's settlement payment as liquidated damages, in fact the payment was in lieu of liquidated damages. The payment was made pursuant to a "Mutual Release of All Claims" signed by Danville and the contractor on November 12, 1974, well after the actual completion of work. That document itemizes the costs Danville incurred after the scheduled contract completion date, including the questioned consulting and resident engineering costs. The settlement does not place liability on either party nor does it assess damages. It compromises doubtful and disputed claims between the parties, including any claims that relate to the time of contract completion. Presumably, as you have pointed out, the change order to extend the completion date was issued only as part of the settlement between Danville and the contractor. The circumstances do not relieve Danville of its responsibility to demonstrate that the extra consulting and resident engineering costs are not due to its mismanagement or the contractor's failure to perform. Inclusion of the overrun costs in the settlement indicates that the parties agreed the contractor was at least in part responsible for those costs. Without documentation to the contrary, the excess costs are unallowable.

Conclusion

Hillsboro and Danville, as grantees, have the burden to show that costs incurred during a contract overrun are not the result of their mismanagement or of their contractors' failures to perform. Otherwise, these costs are unallowable for grant funding. The receipt of liquidated damages is relevant only to the extent that it evidences a contractor's lack of performance. The facts you present indicate that the grantees have not met their burden. Thus, the costs incurred during the contract overrun periods are unallowable.

Conclusion

Hillsboro and Danville, as grantees, have the burden to show that costs incurred during a contract overrun are not the result of their mismanagement or of their contractors' failures to perform. Otherwise, these costs are unallowable for grant funding. The receipt of liquidated damages is relevant only to the extent that it evidences a contractor's lack of performance. The facts you present indicate that the grantees have not met their burden. Thus, the costs incurred during the contract overrun periods are unallowable.